Comptroller of the Currency
Administrator of National Banks

Collective Investment Funds

Comptroller's Handbook

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Asset Management

This booklet provides an overview of collective investment funds (CIFs), outlines their associated risks, and establishes a framework for managing those risks. It applies to CIFs administered by a national bank pursuant to 12 CFR 9.18 and supplements the "Investment Management Services" booklet of the *Comptroller's Handbook.* This booklet also provides expanded examination procedures that supplement the minimum core assessment standards in the "Large Bank Supervision" and "Community Bank Supervision" booklets of the *Comptroller's Handbook.* The use of the expanded procedures is optional; they are designed to be used when the risks posed by a CIF warrant review beyond the standard core assessment.

Background

A CIF is a bank-administered trust that holds commingled assets that meet specific criteria established by 12 CFR 9.18. Each CIF is established under a "plan" that details the terms under which the bank manages and administers the fund's assets. The bank acts as a fiduciary for the CIF and holds legal title to the fund's assets. Participants in a CIF are the beneficial owners of the fund's assets. While each participant owns an undivided interest in the aggregate assets of a CIF, a participant does not directly own any specific asset held by a CIF.

CIFs are designed to enhance investment management by combining assets from different accounts into a single fund with a specific investment strategy. By commingling, or pooling, fiduciary assets, a bank may lower the operational and administrative expenses associated with investing fiduciary assets and enhance risk management and investment performance for the participating accounts.

A fiduciary account's investment in a CIF is called a "participating interest." Like other fiduciary assets, participating interests in a CIF are not FDIC-insured and are not subject to potential claims by a bank's creditors. In addition, a participating interest in a CIF cannot be pledged or otherwise encumbered in favor of a third party.

Many banks establish CIFs as an investment vehicle for their smaller personal trusts or for employee benefit (EB) accounts. By using a CIF, a smaller trust may obtain investment diversification that would otherwise be difficult to achieve. From the bank's perspective, CIFs allow the bank to avoid costly purchases of small lot investments for its smaller fiduciary accounts.

A bank may collectively invest assets of personal fiduciary accounts when either the bank or an affiliate bank serves as the account's trustee, executor, or administrator. The bank may also collectively invest assets of EB accounts such as a retirement, pension, profit-sharing, or stock bonus plans.

12 CFR 9.18 authorizes two general types of CIFs. The first is authorized under section 9.18(a)(1) and is maintained “exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act.” This type of fund is generally referred to as an “A1 fund.”

The second type of CIF is authorized under section 9.18(a)(2) and is “a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from federal income tax.” This type of fund is generally referred to as an “A2 fund.”

In addition to A1 and A2 Funds, section 9.18(c) authorizes other collective investments for national banks to the extent not prohibited by applicable law. A national bank may also request authority from the OCC to establish a “special exemption fund.” These funds are either A1 or A2 funds and contain either a novel investment provision or are otherwise inconsistent with one or more provisions of section 9.18(b). These and other types of CIFs are discussed more thoroughly in appendix A, “Types of Collective Investment Funds.”

Regulatory Overview

When the Federal Reserve Act was enacted in 1913, national banks were, for the first time, provided statutory authority to act in the same fiduciary capacities as state banks operating in the same state. Consistent with common law at the time, Federal Reserve regulations adopted in 1915 prohibited national banks from commingling trust funds.

The first CIF was organized under state law in 1927. In 1936, Congress amended the Internal Revenue Code (IRC) to provide tax-exempt status to certain CIFs maintained by a bank. In 1937, the Federal Reserve promulgated Regulation F that authorized banks to establish common trust funds. In 1938, the National Conference of Commissioners of Uniform State Laws approved the Uniform Common Trust Fund Act and recommended that each state adopt it. Despite the existence of this uniform act, many states crafted their own CIF statutory language resulting in a broad range of CIF statutes. In 1955, the Federal Reserve authorized banks to pool pension, profit-sharing, and stock bonus plans, and the IRS subsequently ruled that such funds could be tax exempt.

In 1962, Congress transferred supervisory responsibility for the fiduciary activities of national banks from the Federal Reserve to the OCC. The

OCC's adoption of 12 CFR part 9 in 1962 authorized national banks to collectively invest funds held as fiduciary in CIFs "where not in contravention of local law." The OCC's adoption of a rule that established standards for CIFs operated by national banks served as a model for subsequently enacted state statutes, many of which cross-reference section 9.18. The OCC's rule has also facilitated compliance by banks with the IRC for A1 funds. The IRC specifically requires funds to conform with OCC rules and regulations in this area if they are to qualify for favorable tax treatment under IRC section 584.

In 1996, the OCC substantially revised part 9. Among the changes is a modification to section 9.18 that now authorizes a national bank to collectively invest assets into A1 and A2 funds "where consistent with applicable law."

The OCC has approved a variety of national bank proposals for the establishment of CIFs to collectively invest assets such as IRA funds and other tax-exempt accounts for which the bank serves as trustee. However, as discussed further in the "Federal Securities Laws" section and appendices C and D, banks offering these funds must be familiar with guidance issued by both the OCC and the Securities and Exchange Commission (SEC) in this area.

12 CFR 9.18

Part 9 allows national banks to maintain and invest fiduciary assets in a CIF "where consistent with applicable law." Applicable law is defined in 12 CFR 9.2(b) as:

- The terms of the instrument governing a fiduciary relationship;
- The law of a state or other jurisdiction governing a national bank's fiduciary relationships;
- Applicable federal law governing those relationships (for example, ERISA, federal tax and securities laws); or
- Any court order pertaining to the relationship.

In many instances, the instrument governing the fiduciary relationship will provide a bank the basis to commingle the account's assets with others. In the absence of express authority provided by the governing instrument, state law generally authorizes a bank to collectively invest fiduciary assets. Generally, fiduciary assets covered by ERISA also may be collectively invested by banks.

Appendix A, "Types of Collective Investment Funds," and appendix B, "12 CFR 9.18(b), Administrative Requirements," provide additional details regarding the different funds a bank may offer and the regulatory requirements the OCC imposes on these funds.

Federal Tax Laws

A significant advantage offered by a CIF is that the capital gains and income received by the CIF are ordinarily not subject to federal taxes. CIFs achieve tax-exempt status by operating in conformance with either IRC section 584 or Revenue Ruling 81-100. Although tax-exempt, a CIF is considered a separate tax entity.

Section 584 of the IRC provides tax exempt status to a CIF that is operated by a bank "exclusively for the collective investment and reinvestment of monies contributed to the bank in its capacity as a trustee, executor, administrator, guardian, or custodian [of an account opened under a state law that is substantially similar to the Uniform Gifts to Minors Act]." Under section 584, the income, capital gains, and losses of the CIF are shared by the CIF participants in proportion to their investment in the CIF. In order to retain its tax-exempt status under section 584, a CIF must operate in compliance with 12 CFR 9.18 as well as the federal tax laws. A1 funds by definition qualify for section 584 status. An A2 fund that strictly limits admission to tax-exempt participants with whom the bank has one of the enumerated trusteed relationships would also qualify for section 584 status.

A2 funds are more commonly granted a tax exemption by Revenue Ruling 81-100 and IRC section 401(a). Because these funds are not limited to the enumerated capacities provided for A1 funds, they may therefore include agency accounts. However, any account that participates in an A2 fund pursuant to Revenue Ruling 81-100 must also incorporate by reference the terms of the CIF's Plan in its governing instrument.[1]

Banks that collectively invest the assets of tax-exempt EB accounts in A2 funds will want to ensure that those funds qualify for the tax exemption granted these CIFs under Revenue Ruling 81-100. In order to qualify for the tax exemption described in the revenue ruling, each EB account participating in the CIF must either qualify as a tax exempt entity under section 401(a) of the IRC or be an entity described in section 818(a)(6) of the IRC, and must also comply with a number of technical requirements.

Banks operating CIFs are required to file annual informational returns with the IRS for each fund established under IRC section 584. While

[1] Governmental plans are not required to incorporate the CIF plan document because they invest pursuant to a specific IRC provision, section 401(a)(24).

there is no specific form for this filing, IRS Form 1065 with Schedule K-1 (Partner's Share of Income, Credits, Deductions) is typically used to satisfy the reporting requirement. The IRS requires information about each fund participant, including name, address, and proportional share of taxable income or losses, and capital gains or losses. This informational return is required, regardless of the taxable income earned during the reporting period.

Federal Securities Laws

A national bank is authorized to administer a CIF and is not required to register the fund under the federal securities laws if the fund qualifies for specific exemptions to the Securities Act of 1933 (the '33 Act) and the exclusions provided in the Investment Company Act of 1940 (the '40 Act). A CIF is fundamentally different from a registered investment company because only eligible assets may be admitted in a CIF. By contrast, funds from any source may be invested in an investment company. See appendix Cfor a more detailed discussion of the '40 Act and its potential impact upon banks offering CIFs.

OCC Banking Circular 247 (September 12, 1990) reminds national banks of the general applicability of the federal securities laws to A1 funds. Banking Circular 247 highlights the longstanding SEC requirement that an A1 fund will only qualify for the statutory exemptions from the '33 Act and the '40 Act if each of the underlying trust relationships is created for "a bona fide fiduciary purpose" rather than as "vehicles for general investment by the public." Congress clarified the '40 Act's exemption requirements for A1 funds in the Gramm-Leach-Bliley Act of 1999 (GLBA). See appendix D for a discussion of special purpose IRA and Keogh CIFs.

ERISA

In addition to complying with tax and securities laws, a bank must also comply with the Employee Retirement Income Security Act of 1974 (ERISA) if one or more employee benefit plans regulated by ERISA participate in the CIF. In general, ERISA prohibits an ERISA fiduciary (such as a bank trustee) from making fiduciary decisions from which it might benefit or from engaging in certain transactions with parties in interest (e.g., certain entities that are related to the plan or provide services to the plan or their affiliates).

ERISA section 408(b)(8) exempts certain transactions from the statutory prohibitions in section 406 of ERISA that restrict transactions between a CIF and a bank administering a CIF (party-in-interest). Section 408(b)(8) allows otherwise prohibited transactions between participating accounts and a CIF if three conditions are met:

- The transaction is a sale or purchase of an interest in the fund;
- The bank does not receive more than reasonable compensation; and
- The instrument under which the plan is maintained, or a fiduciary (other than the bank or bank affiliate) that has authority to control and manage assets of the plan, expressly permits the transaction.

In 1980, the Department of Labor (DOL) granted a class exemption for bank CIFs in Prohibited Transaction Exemption (PTE) 80-51. PTE 80-51permits bank-maintained CIFs with employee benefit plan participants to do business with plan-related parties under certain conditions. DOL amended PTE 80-51 in 1991 and restated it as PTE 91-38. These PTEs allow more types of transactions with related parties if the plan holds no more than a 10 percent interest in the CIF. DOL has issued other class exemptions that a bank may use when it causes a CIF to engage in a transaction that provides some benefit to the bank or its affiliates, or to engage in transactions with a party in interest.[2]

A bank must ensure, however, that it does not violate section 406 of ERISA by causing the CIF to engage in a transaction that benefits the bank, a bank insider, or any other party-in-interest unless the CIF qualifies for either ERISA's statutory exemption (section 408(b)(8)) or one of DOL's class exemptions, or unless the bank obtains an exemption from DOL specifically for its CIF.

Risks

This section addresses risk from the perspective of the OCC's risk assessment system. In most cases, the risks that apply to CIFs are compliance, transaction, strategic, and reputation. Each risk is defined in the "Large Bank Supervision" and "Community Bank Supervision" booklets of the *Comptroller's Handbook*.

The establishment and administration of a CIF creates various types of risk that the bank must effectively manage. The bank must manage the risks associated with operating the CIF and must manage the risks associated with serving as the fiduciary for the participating interests. The bank, as fiduciary with investment discretion, makes the decision to invest a fiduciary account's assets in a CIF, and the bank is subject to conflict of interest restrictions applicable to any fiduciary relationship.

Investment risk is inherent in the individual portfolios and assets that a bank fiduciary manages, or advises, for account principals and beneficiaries.

[2] Examples of other important DOL exemptions used by CIF trustees are PTEs 75-1, 77-4, 81-6, 82-63, and 84-14.

These parties are the actual owners of the assets and assume the associated investment risk. A bank's failure to manage investment risk prudently and in the best interest of a CIF's participants can increase the bank's level of transaction, compliance, reputation, and strategic risk and can have an adverse impact on earnings and capital.

Compliance Risk

A bank that does not comply with applicable law in operating a CIF may face lawsuits and regulatory supervisory action. The financial impact of litigation and regulatory action is difficult to estimate, but it could significantly diminish earnings and capital. In addition, such adverse situations may be highly publicized in the bank's market area and could further damage a bank's reputation.

A bank administering a CIF must comply with the terms of the plan document that specifies the manner in which the bank will operate the CIF. Failure to comply with the plan may result in a regulatory violation. The bank must ensure that only eligible account assets are allowed in CIFs and must also comply with a multitude of other federal laws, regulations, and interpretations. A bank's failure to comply with all applicable federal securities and tax laws may lead to costly regulatory actions, as well as the CIF's loss of favorable tax and securities law treatment, which could potentially affect individual account holders. In addition, a bank operating a CIF must ensure that it complies with applicable state trust investment laws.

Transaction Risk

When administering a CIF, a bank may process a significant volume of transactions and must produce a variety of reports. For example, a bank administering a CIF will generally be required to:

- Account for admissions to and withdrawals from the CIF;
- Execute and account for the purchase and sale of investments;
- Account for the receipt and distribution of investment income (dividends, interest, and capital gains distributions);
- Prepare asset valuations at least every three months for readily marketable assets and at least yearly for assets that are not readily marketable. Many banks, however, choose to value assets on a daily or weekly basis in order to provide current valuations to plan participants;
- Prepare a financial report each 12-month period; and

- Execute contracts with third-party vendors and oversee their performance.

Depending upon the number and variety of CIFs administered by a bank, portfolio investments may include both liquid and illiquid assets from domestic and foreign markets. For banks with CIFs with investment variety and complexity, sophisticated information systems are required. If a bank fails to properly safeguard a CIF's assets or process its transactions (failures that may violate the law), the CIF's losses can lead to client litigation, significant financial losses for the bank, and severe reputation damage. Financial losses have the potential to be large in relation to a bank's earnings and capital, and a damaged reputation can significantly harm a bank's ability to compete.

Strategic Risk

This risk is a function of the compatibility of an organization's strategic goals, the resources deployed in support of those goals, and the quality of implementation. Offering a CIF in conjunction with other fiduciary services is often less expensive than managing individual portfolios, and administering a CIF can indirectly increase a bank's value to shareholders. The business requires, however, a substantial provision of financial, human, and technological resources. A bank's information systems, product development, and personnel expenditures must be appropriate for the diversity and complexity of the CIFs administered. If they are not, the result may be poor earnings performance, wasted capital, and diminished shareholder value.

Reputation Risk

Success in administering a CIF depends on a bank's ability to effectively manage transaction, compliance, and strategic risks and its ability to properly manage the financial risks associated with a CIF. Both personal trust and employee benefit clients are demanding in terms of expected investment performance, product selection, information reporting, service levels, and the use of advanced technology.

Competition is strong for clients whose assets may be invested in a CIF, and negative publicity, whether deserved or not, can damage a bank's ability to compete. In particular, disputes with account beneficiaries can increase reputation risk. Litigation, regulatory action, criminal activity, inadequate products and services, below-average investment performance, poor service quality, or weak strategic initiatives and planning can lead to a diminished reputation and, consequently, an inability to compete and be successful.

Ineffective investment strategies, concentrations of assets that are not readily marketable, or fraud may lead to underperformance or losses in a CIF. A bank must ensure that its CIFs have sufficient liquidity to meet both anticipated and unanticipated events.

While a bank is under no statutory requirement to provide financial support to a CIF, a bank may determine, in order to avoid reputation risk or to mitigate liability, to support a CIF. However, as detailed in OCC Bulletin 2004-2, "Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates," a bank should avoid engaging in the unsafe or unsound practice of inappropriately placing its resources and reputation at risk solely for the benefit of fund participants. A bank's failure to properly manage a CIF could expose the bank's earnings, liquidity, and capital if the bank either provides support to the CIF or if the bank loses business as a result of a poorly managed or underperforming fund.

Risk Management

An effective risk management system is characterized by active board and senior management supervision and sound processes for risk assessment, control, and monitoring. Because risk strategies and organizational structures vary, there is no single risk management system that works for every bank or every CIF. Each bank should establish a risk management system suited to the needs and circumstances of its CIFs. The "Asset Management" and "Investment Management Services" booklets of the *Comptroller's Handbook* provide additional guidance on risk management systems and processes in this area.

Board and Management Supervision

A bank's board of directors must manage or direct a CIF's administration. A board may assign fiduciary management authority to any director, officer, employee, or committee of the bank and may use the qualified personnel and facilities of its affiliates to fulfill its fiduciary responsibilities (see 12 CFR 9.4). Management must ensure that all aspects of a bank-administered CIF comply with applicable law. Management must take special precautions to ensure that procedures are in place to prevent a bank employee from investing ineligible assets in a CIF.

The board may purchase administrative services for a CIF from a third-party vendor. A bank that does so must ensure that it complies with the "exclusive management" requirement set forth at 12 CFR 9.18(b)(2), which allows for prudent delegation to others, as well as with applicable interpretations of the '40 Act. Appendix F ("Guidelines for Selecting Investment Managers and Advisers") in the "Investment Management Services" booklet of the *Comptroller's Handbook* contains factors and criteria a bank should consider when selecting a CIF manager or adviser.

If the board uses the services of a third-party vendor, it must ensure that the vendor conducts its services in a safe and sound manner and in compliance with applicable law. The board and senior management must provide proper oversight of those given the authority to administer the CIF, including a third-party vendor. OCC Bulletin 2001-47, "Third-Party Relationships," provides additional risk management guidance for these types of service arrangements. For example, when a bank relies upon a third-party financial intermediary to serve as a conduit between an EB plan and the bank, the bank must ensure that the third-party vendor has systems in place to ensure that only eligible assets are transferred by the third-party to the bank for admission to the bank's CIFs.

In addition to ensuring that a vendor only refers eligible assets for admission to a CIF, a bank must ensure that appropriate documentation is in place between the bank and a third-party vendor and, when applicable, between that vendor and individual EB plans. The plan, either through the plan sponsor or the trustee, will generally enter into a written agreement with the third-party intermediary that authorizes the intermediary to act as agent for the plan. In that agent capacity, the third party could be authorized to make investment decisions for the plan. Separately, the CIF trustee will customarily have documentation in place with the third-party intermediary that details the parameters the third-party intermediary must adhere to concerning the acceptance of orders into the CIF and the responsibilities the third party is undertaking on behalf of the bank.

The board and senior management are responsible for ensuring that the CIF risk management system includes sound internal controls and an effective audit program. It is critical that the bank adhere to each provision of the CIF plan, particularly those provisions that govern admissions and withdrawals from the CIF and the fund's investment powers and policies.

The board must also ensure that each CIF administered by the bank is audited at least once each 12-month period in accordance with 12 CFR 9.18(b)(6). If CIFs are a significant fiduciary activity for the bank, they must be included in the bank's fiduciary audit program required by 12 CFR 9.9.

The "Asset Management" booklet of the *Comptroller's Handbook* contains additional information on the OCC's expectations for board and management supervision of a bank's overall fiduciary activities.

Policies and Procedures

National banks are required by 12 CFR 9.5 to adopt and follow written policies and procedures that are adequate to maintain their fiduciary activities in compliance with applicable law. In addition, when administering a CIF, a bank must operate the fund in compliance with 12 CFR 9.18(b). The scope and detail of policies and procedures governing a CIF are generally set forth in the fund's plan, which describes how the bank will operate the fund. Appendix B includes a detailed list of the minimum provisions that must be included in a CIF plan.

From a bank's standpoint, the more CIFs the bank offers and the more sophisticated the CIFs' investment strategies, the greater the need for formalized and detailed policies and procedures. The administration of CIFs is a complex activity, as it requires a bank to pool participant assets while ensuring that each participant's interests are served. Appendix E, "Investment Policy Statements," in the "Investment Management Services" booklet of the *Comptroller's Handbook* addresses the factors a bank should consider when drafting or evaluating a CIF's investment objectives and strategies.

Fund Administration

It is a bank's fundamental duty to administer its CIFs solely in the interest of the bank's fiduciary customers whose assets are invested in the funds. When a bank makes a determination that a CIF serves as a prudent alternative to an individualized investment strategy for a fiduciary account, it must ensure that the CIF used is appropriate for each account. The duty of loyalty is critical and underlies the administration of a CIF. Successful administration of a CIF equates to providing an investment opportunity that meets the needs of clients in a safe and productive manner while equitably balancing the interests of each CIF participant.

Review of Participating Accounts

To comply with 12 CFR 9.18 and other federal laws, only eligible accounts may participate in CIFs. Prior to using a CIF as an investment vehicle for an account, the bank must determine that each account is eligible and authorized to participate. Often this is done at the time of account acceptance, with bank personnel reviewing and coding each account as to CIF eligibility. Factors to consider during this initial review include:

- Investment objectives.
- Eligibility for participation based on account type.

- Specific authorization for ERISA-regulated employee benefit plans.
- Whether the plan allows for use of CIFs of the trustee bank, or the trustee bank and affiliates.
- Whether the plan trust document for employee benefit accounts participating pursuant to RR 81-100 in A2 funds incorporates by reference the terms of the CIF's plan.
- If a particular kind of CIF, such as a guaranteed investment contract (GIC) fund, requires an extended notice prior to withdrawal, whether the fund has adhered to standard practice by obtaining a signed acknowledgement of the notice period prior to such investment.

The bank should also conduct periodic reviews to:

- Evaluate the appropriateness of CIF holdings in each account. The reviews may be part of the annual investment reviews for each participating account.
- Ensure the eligibility of all participating accounts in the fund.
- Ensure that interests in CIFs are not used as collateral for loans with the bank.

Internal Controls

CIF Operations

Effective operational controls should be in place to ensure that the bank, either directly or through its ongoing oversight of a third party:

- Values CIF interests at intervals specified in the plan, and prices fund assets to support such valuations.
- Executes admissions and withdrawals on a timely basis, as specified by the terms of the plan.
- Monitors admissions and withdrawals to ensure that there are no opportunities to engage in "late trading"[3] of a fund.

[3] "Late trading" is a participant placing an order to add to or withdraw from a CIF at that day's price after the CIF has closed its books for the day. For most CIFs that are valued daily, the fund's unit or net asset value is determined at 4:00 p.m. Eastern time. Late trading enables the participant to profit from market events that occur after 4:00 p.m. that are not reflected in that day's fund price. In order to prevent late trading, orders received after a day's cut-off must be processed using the next day's price. When a bank uses third parties, particularly electronic trading platforms, to accept participant orders or to maintain fund records, the bank must ensure that each third party has ironclad procedures in place that ensure that orders are assigned the appropriate price based upon when they were received.

- Monitors compliance with plan provisions regarding "market timing"[4] activities.

- Takes fees/expenses appropriately from each fund. Significant expenses, such as audit fees, are generally accrued and expensed throughout the year to spread these costs across all participating accounts.

- Monitors and resolves CIF account overdrafts.

- Arranges for an adequate audit annually.

Fund Administration

CIF administrative controls should be adequate to ensure that the bank:

- Establishes and maintains funds in accordance with a written plan.

- Maintains CIF documents in a central repository.

- Has a formal process through the board of directors of the bank, or a committee appointed by the board, to approve or terminate CIFs.

- Uses qualified counsel.

- Evaluates fees to ensure they are reasonable.

- Maintains adequate board/committee oversight.

The bank is expected to have sound controls over fund plans, third-party contracts, and other original documents that provide the bank with authority to invest assets in a CIF. The controls should ensure that original documents are properly authenticated and preserved for future accountings. Copies may be retained in fund files, but original documentation should be maintained in a centrally controlled location. Original board and committee minutes, with attachments noting approvals and actions taken, should receive the same level of safeguarding.

National banks should have internal policies that outline the bank's position for voting proxies and for handling related social or controversial issues. These policies should include a provision that the bank maintain a record

[4] The SEC has defined "market timing" in the mutual fund context to include: "(a) frequent buying and selling of shares of the same mutual fund, or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal per se, can harm other mutual fund shareholders because it can dilute the value of their shares if the market timer is exploiting pricing inefficiencies, disrupt the management of the mutual fund's investment portfolio, and can cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer." In the Matter of Brean Murray & Co., Inc. (February 17, 2005). These practices may also be used to "market time" a CIF. Historically, the opportunities for market timing have been most available in international equity funds and funds holding thinly traded securities.

of how proxies are voted and, when a decision is made not to vote a proxy, the reasons why that decision was made.

In addition to the mandatory financial report disclosures set forth in 12 CFR 9.18(b)(6), which are described in the "Audits and Financial Reports" section of appendix B, a national bank should consider making available to interested persons the bank's proxy voting policy and CIF proxy voting record. A bank should ensure that any such disclosures are consistent with its fiduciary obligations to its customers as well as the affected CIF. In most cases, the bank, as trustee of a CIF, will be the owner of any security acquired by that CIF for which there is a proxy issue. Accordingly, there is no regulatory requirement that a bank or its CIFs disclose to bank customers or to the public the bank's proxy voting record. A bank may choose to make this information available as part of its 9.18(b)(6) annual disclosures, through periodic communications provided to plan participants, or through other methods of communication.

Securities Lending

A CIF may lend its portfolio securities to certain creditworthy borrowers, such as broker-dealers or banks, in order to generate incremental revenue at relatively low risk. Firms, such as broker-dealers, that routinely borrow securities do so to facilitate their securities trading business.

To mitigate the risk of borrower default, a bank engaged in securities lending must require the borrower to provide collateral. Collateral is generally in the form of cash, securities issued or guaranteed by the U.S. government or its agencies or instrumentalities, or a letter of credit. Borrowers of securities are also customarily required to pay to the CIF the value of any interest, cash, or noncash distributions paid on the securities during the period they are on loan. Industry practice enables either the bank lending the securities or the borrower of the securities to terminate a loan at any time. Upon the termination of a securities lending relationship, the bank obtains from the borrower the return of the securities loaned.

If a borrower collateralizes a securities lending relationship with cash, the borrower will customarily be entitled to receive a portion of the interest earned on the temporary investment of that cash, based upon a negotiated rate. A CIF will generally receive compensation for lending its securities that is based upon the difference between the amount that the CIF earns on the reinvestment of cash collateral and the fee that it pays to the borrower. When a borrower provides noncash collateral, the CIF is compensated through a fee paid by the borrower on the loaned securities. The bank generally receives its compensation for facilitating the securities lending activity by sharing a percentage of the CIF's earnings on the loaned securities, subject to any restrictions under applicable law.

Banks with multiple CIFs that may benefit from securities lending need to have procedures in place to ensure that the benefits of securities lending programs are allocated across those funds.

Securities lending involves exposure to operational risk (i.e., the risk of losses resulting from problems in the settlement and accounting process), “gap” risk (i.e., the risk of a mismatch between the return on cash collateral reinvestments and the fees the CIF has agreed to pay a borrower), and credit, legal, counterparty, and market risks. In the event a borrower does not return a CIF’s securities as agreed, the CIF may experience losses if the proceeds received from liquidating the collateral do not at least equal the value of the loaned security at the time the collateral is liquidated, plus the transaction costs incurred in purchasing replacement securities.

Fund Termination

CIFs may be terminated for a variety of reasons: A bank may find its customer base no longer benefits from the CIF; it may lose a substantial employee benefit customer that participated in the bank’s CIFs; or its business strategy may change over time.

Because of a change in federal tax laws in 1996, neither an A1 fund nor the fund’s customers are required to recognize capital gains if the fund is converted into an investment company. Following that change, some banks converted their A1 funds to investment companies. Though such a conversion is free of federal tax consequences, a bank should be aware of any state tax implications of such a conversion, as well as other accounting and tax issues resulting from such a conversion. In addition, a bank must address potential conflict of interest issues associated with a conversion from an A1 fund to a mutual fund, and the bank must ensure that the mutual fund is suitable for the A1 fund participants being transferred.

When a bank terminates a fund, the bank is responsible for valuing the fund’s assets, distributing those assets, and preparing and filing required reports. A bank should ensure that its risk control processes continue to be strong during the fund termination process.

The terms of the CIF plan control the form and manner of asset distribution from a CIF. If the plan is silent as to the form of distribution, the bank is responsible for developing a plan of distribution. This plan should be approved internally by the board or by its designee. The plan should consider factors such as:

- The type and value of assets,
- Difficulties in dividing the assets,

- Distributions in cash or in kind,
- Tax consequences,
- Timing of distributions,
- Needs and circumstances of remaindermen, and
- Judicial and beneficiary accountings.

Recordkeeping and Reporting

The bank should have procedures to ensure that:

- Annual financial statements are provided or made available to each person who ordinarily would receive a regular accounting with respect to each participating account.
- CIFs are properly reported in Call Report Schedule RC-T.
- A1 funds (and other types of funds using the 3(c)(3) exemption in the '40 Act) are not advertised, except in connection with ordinary advertising of the fiduciary services of the bank, and A2 funds do not advertise predictions of the fund's performance (and comply with other restrictions on advertising).
- Fund records are retained for three years from the later of the termination of the fund or the termination of litigation relating to the fund.
- Fund records are maintained separate and distinct from other nonfiduciary records of the bank.

Periodic Account Reviews (Investment Reviews)

12 CFR 9.6(c) requires the bank, at least once during each calendar year, to conduct a review of all assets for which it has investment discretion. All CIF assets must be reviewed at least once a year; most are reviewed more frequently. The review must determine whether CIF assets are consistent with the fund's plan and investment strategy. The review should focus upon the fund's investment policy statement, analyze investment performance, and reaffirm or change the investment policy statement, including asset allocation guidelines. If certain assets are no longer appropriate for the fund, those assets should be replaced consistent with prudent investment practices. Items to consider include fund objectives, beneficiaries' needs, and income tax consequences.

Fiduciaries should also perform periodic administrative reviews of each CIF to determine whether the fund is being administered in accordance with the terms and conditions of the governing instrument. Periodic fund reviews are generally completed by an administrative officer working with a designated investment manager or adviser, and are normally submitted to and reviewed by an appropriate fiduciary committee.

If investment management is outsourced, the bank must provide adequate oversight, as required by the exclusive management and prudent delegation requirements of 12 CFR 9.18(b)(2).

Audit and Compliance Monitoring

The bank's compliance program should address CIFs. Activities that should receive compliance testing include:

- Account eligibility.
- Procedures for admitting and withdrawing interests of participating accounts.
- Procedures for valuing CIF assets and the participating interests.

As discussed in greater detail in appendix B, 12 CFR 9.18(b)(6) requires an annual audit of each CIF by auditors responsible only to the bank's board of directors; the regulation also requires a bank-prepared financial report of the fund. In most cases, the bank will retain an independent accounting firm to review the financial report and perform the audit required under 12 CFR 9.18. The audit expense is customarily charged to the CIF. This type of audit is primarily a financial statement audit rather than a compliance review. If administration of CIFs is a significant fiduciary activity, the CIF audit should be included in the bank's fiduciary audit program. Internal fiduciary audits should test compliance with 12 CFR 9.18 and other regulations regarding eligibility, management, and other matters, including testing whether fund investments comply with established investment objectives.

Management Information Systems

The board and management must have adequate information systems to access, control, and monitor the risks posed by bank-administered CIFs. In addition to the bank's core trust accounting system, banks administering CIFs customarily use tools to manage accruals, assess fees, and perform CIF unit valuations. These tools range from spreadsheets to sophisticated programs, many of which are created by vendors. The bank should ensure that its information systems are adequate given the nature and complexity of the activities performed. Examples of management information system (MIS) reports used to oversee CIF activities include:

- Financial recordkeeping, such as automated accounting systems designed for the administration and operation of CIFs.
- Senior management information reports to monitor risk, compliance with policies, and the financial performance of the CIFs. These include financial reports, audit reports, compliance reports, control self-assessments, and legal reports.
- Administrative reports to keep track of the day-to-day administration requirements for each fund. These include cash management reports, transaction reports, reports on the timeliness of valuations, and other types of tickler reports.
- Investment performance reports, such as portfolio reviews and transaction reports, for each fund.
- Statements and presentations for customers, including periodic accountings and the annual financial report for each fund.

Expanded procedures provide detailed guidance on how to examine specific activities or products that warrant supervisory review beyond the appropriate core assessment standards for large banks and community banks. The use of the following expanded procedures is optional. Examiners decide whether to use them after reaching core assessment conclusions or during examination planning activities. The decision to use expanded procedures is coordinated with the asset management examiner responsible for planning asset management examination activities for the applicable bank and must be adequately documented in the work papers.

Planning Activities

Objective: To review the quantity of risk and the quality of risk management relating to CIFs and to establish the timing, scope, and work plans for the supervisory activity.

1. Consult the following sources of information (if applicable and available), review the types of CIFs offered by the bank, and gain an understanding of previous supervisory risk assessments:

   - Annual CIF financial reports;
   - OCC information databases;
   - Previous reports of examinations and management letters covering CIFs and investment management activities, analyses, related board and management responses, and work papers;
   - The asset management profile;
   - OCC correspondence files;
   - Call Report Schedule RC-T;
   - Supervisory reports issued by other functional regulators, particularly if the CIFs are advised by an affiliated registered investment adviser or registered separately identifiable department or division (SIDD) of the bank; and
   - CIF monitoring reports from the board, committees, business lines, risk management groups, compliance, legal, and audit functions.

2. Discuss the following with managers responsible for CIFs:

   - Significant risk issues and management strategies including, when CIFs and affiliated investment companies are both offered, the objectives and strategies for using one fund rather than the other;
   - Significant changes in strategies, products, services, and distribution channels;
   - Significant changes in organization, policies, controls, and information systems; and
   - External factors that are affecting services, particularly the use of third-party vendors and automated trading platforms.

3. Develop a preliminary risk assessment and discuss it with the asset management EIC and/or the bank EIC for perspective and examination planning coordination. Consider the following:

   - Previous examination conclusions and recommendations;
   - Internal risk and control assessments;
   - Strategic and business plans;

- Introduction of new funds or significant modifications to existing funds; and
- Changes in organization, policies, procedures, controls, and information systems.

4. Reconfirm and finalize the timing, scope, and work plans for examination activity to be completed during the supervisory cycle. Decisions concerning the use of expanded procedures should be clearly documented.

5. If applicable, prepare and submit a revised examination planning memorandum for approval by the asset management EIC that includes the following information:

   - Examination activity objectives including a description of the types of CIFs or fund processes to be reviewed.
   - The types (on-site and quarterly monitoring), schedules, and projected workdays of the examination activity.
   - The scope of examination procedures to be completed, including the use of expanded procedures and risk-oriented sampling guidelines. The memorandum should address the amount of testing or direct verification that may be necessary. The scope of examination activity and the selected procedures should be consistent with the risk assessment and should focus on higher risk activities.
   - The examiner resources necessary to complete the activities.
   - The types of communication planned, such as meetings and final written products.

6. Finalize the examination's work assignments.

7. Discuss the examination plan with appropriate bank personnel and make suitable arrangements for on-site accommodations and additional information requests.

8. If applicable, contact each examination team member and provide necessary details concerning examination assignments and schedules.

   The "Examination Planning and Control," "Large Bank Supervision," "Community Bank Supervision," and "Asset Management" booklets of the *Comptroller's Handbook* contain additional guidance on and procedures for examination planning activities.

Quantity of Risk

Objective: To determine the types of risk and the quantity of risk generated by the administration of CIFs.

1. Obtain and review the most recent OCC examination of the bank's fiduciary operations:

   - Discuss the findings and recommendations relating to CIF administration with OCC examiners and bank management.
   - Determine whether the bank has followed through on its commitments to take corrective action or to follow other recommendations.

2. Obtain and analyze management information reports relating to transaction processing and reporting by CIF managers. Consider the following factors:

   - The volume, type, and complexity of CIF transactions;
   - The condition, security, capacity, and recoverability of systems;
   - The complexity and volume of conversions, integrations, and system changes;
   - The development of new products, services, technology, and delivery systems to maintain competitive position and to gain strategic advantage; and
   - The volume and severity of operational, administrative, and accounting control exceptions and losses from fraud and operating errors.

3. Obtain and review the most recently completed information technology examination activity:

   - Discuss the findings and recommendations relating to CIFs with management.
   - Determine whether commitments to corrective action have been carried out and whether supervisory recommendations have been adequately addressed.

4. Obtain and analyze the types and significance of policy exceptions, internal control deficiencies, and legal violations that have been identified and reported internally. Review information from the following sources:

   - Board and committee minutes and reports.
   - Risk management and compliance division reports.
   - Written CIF plans.

- Governing instruments for A2 funds providing federal tax exemption.
- Annual CIF audit reports.
- Control self-assessment reports.
- Internal and external audit reports.
- Other OCC examination programs.

5. Obtain and analyze the types and volume of litigation and customer complaints related to CIFs:

   - Discuss significant litigation and complaints with management.
   - Determine the risk to capital and the appropriateness of corrective action and follow-up processes.

   If necessary, refer to the “Litigation and Other Legal Matters” booklet of the *Comptroller’s Handbook* for additional procedures.

6. Evaluate compliance with bank policies and operating procedures, and “applicable law” including:

   - The governing instrument,
   - 12 CFR 9.18,
   - Court orders, and
   - Federal laws, including securities, tax, and, when applicable, ERISA.

7. Discuss with management the impact of the factors listed below on the types of risk and quantity of risk generated by CIFs:

   - The number and types of funds;
   - Merger and acquisition plans and opportunities;
   - Potential expansion through multi-state fiduciary operations;
   - Potential or planned offering of new funds, particularly those that may test legal boundaries;
   - Economic, industry, and market conditions;
   - Legislative and regulatory change;
   - Technological advances;
   - Competition, particularly from investment companies, hedge funds, and other investment vehicles;
   - The market or public’s perception of the bank’s financial stability; and
   - The market or public’s perception of the CIFs offered by the bank.

8. Obtain and analyze conclusions from the CIF “Quality of Risk Management” examination procedures. Incorporate those conclusions into the risk assessment of CIFs.

9. Reach conclusions on the types of risk and quantity of risk generated by the administration of CIFs and forward this information to the "Examination Conclusions" section.

Quality of Risk Management

Board and Management Supervision

Objective: To determine the quality of board and management risk controls and monitoring systems.

1. Determine and evaluate the types of CIF risk control and monitoring systems used by the board and management. Consider the following:

    - Board and senior management reporting;
    - Audit program;
    - CIF risk management groups;
    - CIF committee structures, responsibilities, and performance;
    - Management information systems;
    - Frequency, content, and usefulness of litigation reports;
    - Compliance programs; and
    - Control self-assessments.

2. Evaluate the effectiveness of board and senior management supervision of risk from CIF administration. Consider:

    - The types and frequency of board and senior management CIF reviews used to determine adherence to policies, operating procedures, and strategic initiatives;
    - The accuracy, timeliness, relevance, and distribution of management information reports;
    - The responsiveness to risk control deficiencies and the effectiveness of corrective action and follow-up activities;
    - The responsiveness to potential or actual litigation; and
    - The responsiveness to internal and external audits and regulatory examinations.

3. Evaluate the CIF compliance program. Consider:

    - The strength of board and senior management commitment and support;
    - Line management responsibility and accountability;
    - Program formalization, transaction testing, reporting structures, and follow-up processes;
    - Qualifications and performance of compliance officer and supporting personnel;
    - Communication systems; and
    - Training programs.

4. If the bank has implemented a control self-assessment program, obtain information on its assessment of controls in the CIF area. Evaluate the program and the results of recent control self-assessments of business and support functions.

Objective: To determine the quality of established policies and procedures and their consistency with the bank's strategic direction for CIFs.

1. Identify and obtain the bank's policies and strategic plan relating to CIFs.

2. Evaluate the policy and procedures. Consider the following:

   - Is the policy formally approved and periodically reviewed by the board or a designated committee?
   - Does the policy adequately address applicable law including 12 CFR 9.18?
   - Does the policy establish a risk management and internal control framework that addresses
     - Organizational and functional charts?
     - Defined lines of authority and responsibility?
     - Delegation authority and approval processes?
     - Processes to select, employ, and evaluate legal counsel?
     - Standards for dealings with affiliated organizations?
     - Conflicts of interest?
     - Personnel practices?
   - Does the policy include appropriate screening and review guidelines of new and existing fund assets to ensure that only eligible assets are invested in a CIF? Guidelines should address:
     - New asset investment processes;
     - Asset reviews;
     - Investment reviews;
     - Cash management;
     - Fees and other expenses;
     - Tax preparation and reporting; and
     - Fund termination.
   - Does the policy effectively address information systems and technology applications? Consider
     - Accounting and other transaction recordkeeping systems;
     - Management information system requirements;
     - Customer information security; and
     - Systems security and disaster contingency plans.
   - Does the policy establish
     - Policy exception definitions and guidelines;
     - Policy exception tracking and reporting processes;
     - Client reporting guidelines;

- – Proxy voting standards;
- – Control self-assessment processes; and
- – Customer complaint resolution procedures?

Are these guidelines and processes adequate?

3. Review the strategic plan and supporting financial projections and determine whether the policy is consistent with the bank's strategic goals and objectives.

4. Review how strategic initiatives and policies are communicated within the organization and determine whether the communication processes are adequate.

5. If deficiencies are identified in the policymaking and implementation process, discuss them with management and document the conclusions and recommendations.

Objective: To determine the quality of CIF management and supporting personnel.

1. Obtain a list of CIF management and key supporting personnel that includes the following information:

   - Title and job responsibilities,
   - Formal education and training, and
   - Related work experience and accomplishments. CIF management will include any bank director, fiduciary committee member, CIF manager, account administrator, third-party vendor, or other bank employee responsible for developing, approving, or implementing CIF business strategies, policies, and information systems.

2. Review CIF management and supporting personnel and determine whether management is

   - Competent based on the size and investment strategies of the bank's CIFs;
   - Knowledgeable of CIF eligibility requirements, investment strategies, and risk tolerance standards; and
   - Aware of the bank's code of ethics, if applicable, and committed to high ethical standards.

3. Evaluate the adequacy of staffing levels by reviewing and discussing:

   - Current strategic initiatives and financial goals;
   - Current fund volume, complexity, and risk profiles;
   - Recent staffing analyses and recommendations; and

- Impact of company cost-cutting programs, if applicable.

4. Compare job descriptions and other responsibilities of managers and key supporting personnel with their experience, education, and other training. Determine whether

   - Personnel are qualified and adequately trained for positions and responsibilities.
   - The number of funds and other responsibilities assigned to administrators appear reasonable.
   - Personnel perform tasks outside their job descriptions that adversely affect their overall performance or that pose unacceptable risk to the bank.

5. Evaluate the bank's recruitment and employee retention program by reviewing the following:

   - Recent successes in hiring and retaining high-quality personnel;
   - Level and trends of staff turnover, particularly in key positions; and
   - The quality and reasonableness of management succession plans.

6. Analyze the compensation and performance evaluation program:

   - Is the program formalized and periodically reviewed by the board and senior management?
   - Is the program consistent with the bank's risk tolerance and ethical standards?
   - Are responsibilities and accountability standards clearly established for the performance evaluation program?
   - Is the program applied consistently and functioning as intended?
   - Does the program reward behavior and performance that is consistent with the bank's ethical culture, risk tolerance standards, and strategic initiatives?
   - Does the program include an adequate mechanism for the board to evaluate management performance?

7. Review the training program by considering the following:

   - The types and frequency of training and whether the program is adequate and effective;
   - How resources are allocated to CIF training and whether the financial resources provided are adequate; and
   - Whether employee training needs and accomplishments are a component of the performance evaluation program.

CIF Audit and Internal Controls

Objective: To determine the adequacy and effectiveness of the bank's CIF audit program.

1. Obtain and evaluate the annual audit and related financial reports prepared in accordance with 12 CFR 9.18(b)(6). Review for compliance with the regulation's requirements and for identified control weaknesses. Determine whether management has adequately addressed control deficiencies.

2. Review the bank's 12 CFR 9.9 fiduciary audit relating to its CIF activities, if applicable. Determine whether the internal and external audit program is effective and reliable. In the course of the review,

   - Select and complete appropriate examination procedures from the "Internal and External Audits" booklet of the *Comptroller's Handbook.* Coordinate the selection of procedures with the examiner responsible for evaluating the bank's audit program.
   - Obtain appropriate internal audit reports, work papers, and follow-up reports. Disseminate the reports to the appropriate examiners for review and follow-up.
   - Determine the adequacy and effectiveness of the internal audit program by reviewing:
     – The timing, scope, and results of audit activity;
     – The quality of audit reports, work papers, and follow-up processes; and
     – The independence, qualifications, and competency of audit staff.

   - If the review of audit reports and work papers raises questions about audit effectiveness, discuss the issues with appropriate examiners and determine whether the scope of the audit review should be expanded. Issues that might require an expanded scope include:
     – Unexplained or unexpected changes in auditors or significant changes in the audit program;
     – Inadequate scope of the audit program;
     – Audit work papers that are deficient or do not support audit conclusions;
     – High-growth areas without adequate audit coverage; and
     – Inappropriate actions by insiders to influence the findings or scope of audits.

3. Draw conclusions about the adequacy and effectiveness of the audit program and forward the findings and recommendations, if applicable, to the examiner responsible for evaluating the bank's audit program.

Objective: To determine the adequacy and effectiveness of CIF internal controls.

1. As appropriate and approved by the bank EIC and internal control examiner, select and complete appropriate internal control examination procedures from the "Internal Control" booklet of the *Comptroller's Handbook.*

2. After completing the examination procedures selected above and reviewing the results of the control systems examination procedures, draw conclusions on internal control for CIF services.

Table 1.

	Strong	**Satisfactory**	**Weak**
Control Environment			
Risk Assessment			
Control Activities			
Accounting, Information, and Communication			
Self-assessment and Monitoring			

The overall system of internal control for collective investment fund services is

Table 2.

Strong	**Satisfactory**	**Weak**

3. Submit the assessment of internal control to the examiner responsible for evaluating internal control for asset management activities.

Fund Administration Processes

Objective: To determine the quality and effectiveness of CIF administration processes.

1. Select a sample of CIFs, including recently established CIFs. If possible, include a variety of fund types: personal trust, employee benefit, and specialized funds.

2. For each new fund selected, determine whether the fund approval process was adequate and effective. Consider:

   - CIF compliance with federal, state, and local laws;
   - The bank's level of technical expertise and operational capabilities;
   - The bank's duties and obligations as administrator of the CIF;
   - The terms and conditions of the plan;
   - Current or foreseeable problems in administering the CIF;
   - Potential or actual conflicts of interest;
   - Potential environmental issues, if applicable, given the investment strategy of the fund;
   - The adequacy and reasonableness of the CIF fee structure and whether the bank is adequately compensated for the risks associated with administering the fund;
   - Any services provided by a third-party vendor; and
   - Input from portfolio managers, risk managers, and legal counsel.

3. Review each selected CIF and determine whether investment management and ongoing administrative processes are adequate and effective. Determine whether:

   - The investment of fund assets complies with the fund's governing instrument and the investment objective of the fund;
   - The bank performs account reviews in accordance with 12 CFR 9.6(c) and other applicable law;
   - The bank prepares and provides accurate account statements as required by 12 CFR 9.18(b)(6) and any additional required accountings;
   - The bank avoids conflicts of interest and self-dealing;
   - The bank charges and reports accurate fund fees and complies with the management fee and expense provisions of 12 CFR 9.18(b)(9) and (10); and

- Any services provided by a third-party vendor are properly performed and the vendor's charges are appropriate and reasonable.

4. Determine whether CIF managers and administrators have an adequate knowledge and understanding of the funds assigned to them:

   - Are CIFs assigned to a specific administrator?
   - Are CIF managers aware of problems such as litigation, complaints, and other important administrative matters?
   - Have fund administrators maintained records in accordance with policy and sound administrative practices?

5. Evaluate the bank's processes for administering accounts invested in CIFs operated by an affiliated bank:

   - Determine whether proper and timely written authorizations are obtained when these approvals may be required for important actions;
   - Determine the appropriateness of the CIF for the bank's fiduciary accounts.

6. Evaluate the fund's cash management processes:

   - Identify and review large uninvested or undistributed cash balances and discuss them with management. Determine whether administration of the fund is appropriate and complies with 12 CFR 9.10, "Fiduciary Funds Awaiting Investment or Distribution," and with the terms of the fund's plan as required by 12 CFR 9.18(b)(1).
   - Review fund overdrafts, giving attention to large and longstanding items. Determine why they exist and discuss management's plans to clear them.

7. Evaluate the bank's recordkeeping and client reporting processes.

   - Is fund income properly received and recorded? Does the bank properly allocate cash to income and principal in accordance with the plan or applicable law?
   - Do admissions and withdrawals comply with the fund's plan, other applicable law, and internal policy?
   - Are fees and expenses appropriate, accurate, and consistent with 12 CFR 9.18(b)(9) and (10)?
   - Does the bank have an account statement distribution policy and supporting procedures? Is the bank complying with the policy?
   - Are statements and reports prepared and distributed to persons entitled to them?

8. Review CIF tax administration and evaluate the process to prepare and file CIF-related tax returns:

   - Are federal and state tax returns filed on time?
   - Are appropriate valuations performed on fund assets?

9. Evaluate the bank's process for terminating CIFs:

   - Is the process clearly defined with specified approval authority?
   - Is a review by legal counsel part of the process?
   - Are appropriate allocations of income determined at the time of closing?
   - Is the fee unit notified when an account is terminated?
   - Are estate and federal income tax issues appropriately considered?
   - Is an adequate plan of distribution created?
   - Are judicial accountings appropriately administered?

Objective: To determine how well the bank administers participating accounts.

1. Select an appropriate sample of accounts with assets invested in CIFs. A sufficient number of accounts should be selected to form a reliable assessment of the bank's processes. Account selection may be based on risk factors such as size, complexity, litigation, and insider relationships, but the sample must be of sufficient size to satisfy the examination's objectives.

2. Review each selected account and determine whether administrative processes are adequate and effective. Determine whether:

   - The investment of account assets in a CIF complies with the terms of the governing instrument and meets the needs of account beneficiaries according to their circumstances;
   - The bank has determined that the account is eligible for admission to the A1 or A2 fund;
   - The use of a CIF for the account complies with federal laws, state and local laws, and court orders and directions;
   - The bank performs account reviews in accordance with 12 CFR 9.6(c) and other applicable law;
   - The bank prepares and provides accurate account statements as required by 12 CFR 9.18(b)(6) and any additional required accountings;
   - The bank avoids conflicts of interest and self-dealing;
   - The bank charges and reports accurate fund fees and complies with the management fee and expense provisions of 12 CFR 9.18(b)(9) and (10); and

- Any services provided a third-party vendor are properly performed and appropriately documented, and the vendor's charges are appropriate and reasonable.

Objective: To determine the quality and effectiveness of CIF admission processes.

1. Evaluate the bank's CIF admission and withdrawal process.

   - Is the process formalized and adequately documented?
   - Are relationships with third-party financial intermediaries appropriately documented?
   - Is appropriate information obtained during the due diligence review and effectively used in the approval process?
   - Is the process complied with? Does it include an appropriate approval process for policy exceptions?
   - Does the process include monitoring for potential "late trading" and other preferential treatment in trading practices by CIF participants?
   - Does the process include monitoring for potential "market timing," particularly when the plan's terms prohibit this practice or when a fund is particularly susceptible to market timing?
   - Does the acceptance process comply with the requirements of 12 CFR 9.18?
   - Does the withdrawal process comply with the requirements of 12 CFR 9.18?

2. Select a sample of recently admitted accounts for review. If possible, include a variety of account types, including personal trust and employee benefit.

3. For each selected account, determine whether the account admission process was adequate and effective. Consider the following:

   - The bank's level of technical expertise and operational capabilities;
   - The bank's duties and obligations as administrator of the CIF;
   - The bank's reliance on third-party intermediaries;
   - The terms and conditions of the governing instrument and the character of the account parties;
   - Current or foreseeable problems in administering the account;
   - Whether the bank is adequately compensated for accepting the risks of administering the account;
   - The types of assets currently in the portfolio and the types of assets to be purchased and managed in the portfolio;
   - Environmental review issues;
   - Input from portfolio managers, risk managers, and legal counsel;

- Potential or actual conflicts of interests;
- Prior fiduciary administration, particularly successor trustee accounts; and
- Co-trustee relationships.

Objective: Determine the adequacy and effectiveness of processes used to develop and approve new funds.

1. Evaluate how management plans for and develops new funds. Consider the following:

    - Types of market research conducted, such as product feasibility studies;
    - Cost, pricing, and profitability analyses;
    - Risk assessment processes;
    - Legal counsel and review;
    - Role of risk management and audit functions;
    - Information systems and technology impact; and
    - Human resource requirements.

2. Evaluate the product approval process by selecting a sample of funds developed and introduced since the last examination of this area:

    - Is the approval authority clearly established and adhered to?
    - Were bank policies and procedures adequately followed?
    - Does the process require adequate documentation of the factors considered and adequate support for the final decision?

Objective: To determine the adequacy and effectiveness of third-party vendor selection and monitoring processes.

1. Review policies and procedures for the selection and monitoring of third-party vendors. Discuss the process with management, and document significant weaknesses in risk management processes. Consider the following:

    - The quality of the due diligence review process;
    - The contract negotiation and approval process;
    - Risk assessment processes, including consideration of the exclusive management and “prudent delegation” provisions of 12 CFR 9.18(b)(2);
    - Risk management and audit division participation;
    - Vendor monitoring processes, such as the assignment of responsibility, the frequency of reviews, and the quality of information reports reviewed; and
    - The process for resolving problems with vendors.

2. Obtain a list of vendors used by the bank to provide CIF services and support. Select a sample from the vendor list, and evaluate the adequacy and effectiveness of the bank's selection and monitoring processes for each vendor selected. Determine whether the selection and monitoring process require:

   - The vendor to be familiar with 12 CFR 9 and the implications of a bank breaching its fiduciary duties; and
   - The bank's contract with the vendor to include a provision that the vendor will establish adequate information-security programs to safeguard customer information consistent with 12 CFR 30 (appendix B).

3. Review documentation whose subject is any agreement between the bank and the vendor that calls upon the vendor to provide assets to be invested in the bank's CIFs.

4. Review policies and procedures used by the bank to ensure that recordkeepers and other intermediaries with access to bank CIFs have effective policies in place to prevent "late trading" and other preferential treatment in trading practices provided to plan participants.

5. For plans that restrict or prohibit "market timing," and for funds that are particularly susceptible to market timing, review policies and procedures used by the bank to ensure that recordkeepers and other intermediaries with access to bank CIFs have policies in place to deter or prevent market timing of the fund.

Examination Conclusions

Objective: To consolidate the conclusions and recommendations from the CIF examination activities into final conclusions on the quantity of risk and quality of risk management.

1. Obtain conclusion memoranda and other risk assessment products from completed examination procedures.

2. Discuss the individual examination findings with the responsible examiners and ensure that conclusions and recommendations are accurate, supported, and appropriately communicated.

3. Determine and document the recommended rating for the “compliance” element based on the factors listed in the Uniform Interagency Trust Rating System (UITRS).

4. Finalize quantity of risk and quality of risk management conclusions for input into the following, when applicable:

   - Core knowledge database.
   - Core assessment standards (CAS).
   - Risk assessment system (RAS).
   - Uniform Interagency Trust Rating System (UITRS).
   - CAMELS.
   - Report of examination.
   - Asset management profile (AMP).

Objective: To communicate examination findings and initiate corrective action, if applicable.

1. Provide the EIC the following information, when applicable:

   - Examination summary comments for the core assessment.
   - Comments applicable to the RAS.
   - UITRS ratings recommendations.
   - Draft report of examination comments.
   - Matters requiring attention (MRA).
   - Violations of law and regulation and corrective action.
   - Other recommendations provided to bank management.

2. Discuss examination findings with the EIC and adjust findings and recommendations as needed. If the UITRS compliance rating is 3 or worse or if the level of any risk factor is moderate and increasing or high because of the impact of collective investment fund activities, contact the supervisory office before providing draft examination

conclusions or report comments and before conducting the exit meeting with management.

3. Hold an exit meeting with appropriate CIF committees and/or other risk managers to communicate examination conclusions and obtain commitments for corrective action, if applicable. Allow management time before the meeting to review draft examination conclusions and report comments.

4. Prepare final comments for the report of examination as requested by the EIC. Perform a final check to determine whether comments

   - Meet OCC report of examination guidelines.
   - Support assigned UITRS ratings.
   - Contain accurate violation citations.

5. If there are MRA comments, enter them in the OCC's electronic information system. Ensure that the comments are consistent with MRA content requirements.

6. Prepare appropriate comments for the CIF examination conclusion memorandum. Supplement the memorandum's comments, when appropriate, to include the following:

   - The objectives and scope of completed supervisory activities;
   - Reasons for changes in the supervisory strategy, if applicable;
   - Overall conclusions, recommendations for corrective action, and management's commitments and time frames; and
   - Comments on any recommended administrative actions, enforcement actions, and civil money penalty referrals.

7. Update applicable sections of the OCC's electronic information system.

8. Prepare an updated supervisory strategy for CIF administration and provide it to the asset management EIC for review and approval.

9. Prepare a memorandum or update work programs with any information that will facilitate future examinations.

10. Organize and reference work papers in accordance with OCC guidelines.

11. Complete and distribute assignment evaluations for assisting examiners, as appropriate.

Types of Collective Investment Funds

A1 and A2 Funds

An A1 fund is established under 12 CFR 9.18(a)(1) and is limited to assets held by the sponsoring bank, or by an affiliate, as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act. The industry generally uses the term "common trust fund" when referring to A1 funds.

An A2 fund is established under 12 CFR 9.18(a)(2) and may consist only of assets of retirement, pension, profit sharing, stock bonus, or other trusts that are exempt from federal income tax. The industry generally uses the term "collective investment fund" when referring to A2 funds.

A bank is not required to be a fiduciary with discretion in order to commingle assets in an A2 plan. For purposes of an A2 plan, a bank may serve as directed agent or nondiscretionary custodian for an employee benefit (EB) plan account and may invest plan assets into its A2 fund, so long as the fund itself qualifies for an exemption from federal taxation. The bank need not act as the trustee for the underlying tax-exempt trust.

A bank is authorized by 12 CFR 9.18(a)(2)(i) to combine assets eligible for participation in an A2 fund into an A1 fund, so long as the bank serves as trustee for the underlying EB plan(s). However, a bank should carefully consider both the tax and securities law implications of combining assets in this way. It would be unusual for a bank to combine assets subject to different tax treatments or with different investment objectives into a single A1 fund. A bank may establish a network of funds or a "fund of funds" in which assets of one or more A2 funds are invested in another A2 fund. Banks should ensure that admissions into their CIFs are closely scrutinized to ensure that ineligible accounts are not admitted into a CIF. The admission of even one ineligible account into a CIF could potentially raise tax and securities implications for the entire fund.

A subset of both A1 and A2 funds are "short-term investment funds," or "STIFs." A STIF is a CIF that, while analogous to a money market mutual fund (MMMF), has significant differences. STIFs are similar to MMMFs because they offer liquidity, an optimum return, and a stable value. Unlike MMMFs, however, STIFs are not required to maintain a stable net asset value or price per share as their primary objective. In addition, STIFs do not operate under the same portfolio quality and diversification requirements as MMMFs. STIFs must comply with the valuation and recordkeeping requirements of 9.18 rather than Rule 2a-7 of the '40 Act, which imposes the standards for MMMFs. STIFs and MMMFs are both required to limit their dollar-weighted average portfolio maturities to 90 days or less. STIFs, however, are not bound by the maximum maturity limit of 397 days for most single securities held in an MMMF.

Other Collective Investments – 9.18(c) Funds

12 CFR 9.18(c) authorizes other collective investments for national banks in addition to those authorized under 9.18(a). The OCC recognizes other specific arrangements by which a national bank may collectively invest assets that it holds as a fiduciary, so long as applicable law does not prohibit those arrangements. Bank counsel should ensure that any such collective investment meets the required exemptions from applicable federal securities laws. These narrowly defined collective arrangements, which are described below, are not subject to the provisions of 12 CFR 9.18(b) detailed in appendix B.

Single Loans or Obligations

A national bank may collectively invest assets that it holds as fiduciary in:

- A single real estate loan, a direct obligation of the United States, an obligation fully guaranteed by the United States, or a single fixed amount security, obligation, or other property, either real, personal, or mixed, of a single issuer; or
- A variable amount note of a borrower of prime credit, if the bank uses the note solely for investment of funds held in its fiduciary accounts.

Mini-funds

A national bank often receives or holds relatively small dollar accounts in its capacity as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act. Because cash balances in these accounts are often too small to be advantageously invested separately, the bank may establish a fund expressly for these balances' collective investment. The maximum amount of assets that may be held in such a "mini-fund" is $1,000,000, and the maximum number of participating accounts in any one mini-fund is 100.

Trust Funds of Corporations and Closely-related Entities

When a trust is created by a corporation (including its affiliates and subsidiaries), or by several individual but closely related settlors, a national bank is authorized to collectively invest the trust assets that it holds as a fiduciary in any investment specifically authorized by the instrument creating the fiduciary account or by court order.

Other Authorized Funds

To the extent another collective fund arrangement is expressly authorized by applicable law, a national bank may establish such a fund. For example, many states have statutory provisions for pre-need funeral trusts and the collective investment of the funds deposited into those trusts. This provision authorizes a national bank to establish a fund consistent with those specific state statutes.

Special Exemption Funds

The OCC's CIF regulations include a procedure under 12 CFR 9.18(c)(5) for the OCC to consider new types of funds, and to consider modifications to existing types of funds. With OCC approval, banks are provided a means to operate an A1 or A2 fund and not comply with some or all of the provisions of sections 9.18(a) and (b). Since the issuance of revised part 9 in 1996, however, the OCC has had few occasions to issue "(c)(5)" interpretive letters. This is because section 9.18 is a permissive regulation that, in most situations, authorizes a particular CIF activity "where consistent with applicable law."

Other Commingled Funds

A bank may serve as an administrator, investment adviser, or investment manager of a pooled income fund. These are funds maintained by a third-party organization, such as a church or an educational institution. These pooled funds customarily pool charitable gifts from individual donors. Pooled funds are not CIFs and may not be operated by a bank as a CIF. Pooled funds are not governed by OCC Regulation 9.18, but instead must fall within specific exemptions provided under the federal tax and securities laws.

12 CFR 9.18(b), Administrative Requirements

12 CFR 9.18(b) establishes the administrative requirements that a bank must comply with if it establishes and administers a CIF authorized under section 9.18(a). These requirements are in addition to and distinct from a bank's other fiduciary responsibilities.

Written Plan – 9.18(b)(1)

The board of directors of a national bank, or a committee authorized by the board, must approve through resolution a written plan for each CIF operated by the bank. Though the regulation does not dictate a plan's specific terms, a plan must contain appropriate provisions regarding the manner in which a bank will operate the fund. At a minimum, a plan must include provisions relating to:

- Investment powers and policies with respect to the fund;
- Allocation of income, profits, and losses;
- Fees and expenses that will be charged to the fund and to participating accounts;
- Terms and conditions governing the admission and withdrawal of participating accounts;
- Audits of participating accounts;
- Basis and method of valuing assets in the fund;
- Expected frequency for income distribution to participating accounts;
- Minimum frequency for valuation of fund assets;
- How much time the bank has, following a valuation date, to do the valuation;
- Bases upon which the bank may terminate the fund; and
- Any other matters necessary to define clearly the rights of participating accounts.

A bank must make a copy of the plan available for public inspection at its main office and must provide a copy of the plan to anyone who requests it. Banks are no longer required to submit copies of CIF plans to the OCC.

Fund Management – 9.18(b)(2)

A bank administering a CIF must have exclusive management of that fund, except as a prudent person might delegate responsibilities to others. Section 9.18(b)(2) allows a bank to delegate CIF responsibilities to others if prudent to do so.

The delegation standard is derived from the American Law Institute's Restatement (Third) of Trusts (1992), section 171, Duty with Respect to Delegation, and section 227, General Standard of Prudent Investment (Prudent Investor Rule). The "Investment Management Services" booklet of the *Comptroller's Handbook* (appendix B, "Trust Investment Law") provides a detailed review of the prudent investor rule.

Delegation decisions are matters of fiduciary judgment and discretion. A bank must exercise care, skill, and caution in selecting agents and in negotiating and establishing terms of delegation, including investment responsibilities. In deciding whether to delegate responsibilities, the bank should balance the anticipated benefits against the costs of delegation. See discussion of "Expenses" under 9.18(b)(10) below. OCC Bulletin 2001-47, "Third-Party Relationships," provides additional risk management guidance for these types of service arrangements.

Proportionate Interests – 9.18(b)(3)

All participating accounts in a CIF are required to have a proportionate interest in all the fund's assets. To the extent a CIF charges different fees to fund participants, when that differential is based upon the amount and type of services the bank provides, the bank must ensure that all participants retain a proportionate interest in the assets of the CIF.

Valuation – 9.18(b)(4)

A bank administering a CIF must determine the market value of the fund's assets at least once every three months. Valuation dates must be established by the fund's written plan. If the bank cannot readily ascertain the market value of a particular asset, the bank shall use a "fair value" determined in good faith.

This section includes an accommodation for CIFs that are invested in assets such as real estate or private equity securities — that is, securities that are not readily marketable. A bank is required to determine the value of those assets only once each year, rather than quarterly.

Short-term investment funds (STIF). A bank may value a STIF's assets on a cost basis, rather than at market value, for purposes of admissions and withdrawals, provided that the fund:

- Maintains a dollar-weighted average portfolio maturity of 90 days or less;
- Accrues on a straight-line basis the difference between the cost and anticipated principal receipt on maturity; and
- Customarily holds the fund's assets until maturity.

The OCC's STIF valuation provisions are based upon the SEC's Money Market Fund Rule 2a-7, which interprets provisions of the '40 Act.

Guaranteed investment contracts (GICs) and synthetic investment contracts (SICs). In Interpretive Letter No. 716 (1995), the OCC modified valuation requirements for CIFs that purchase GICs and SICs.[5] GICs and SICs are contracts that have almost no liquidity because the contract terms generally prohibit their transfer. GICs are individually negotiated investment contracts between insurance companies and investors. SICs are individually negotiated investment contracts that provide cash flow protection for assets or pools of assets to investors who own those assets and who must sell those assets to pay plan participants.

Consistent with accounting guidance, Interpretive Letter 716 permits CIFs consisting solely of defined contribution plan assets (rather than defined benefit plan assets) that are invested solely in fully benefit-responsive GICs and SICs and liquid, short-term government securities and money market instruments to value the GICs and SICs at contract value rather than fair value. Contract value is the principal balance plus accrued interest. Although accounting guidance requires defined benefit plans invested solely in GICs and SICs to be valued at fair value, the fair value of these contracts is usually equal to their contract value.

Valuation dates. Unless specified by a fund's written plan, there is no requirement that admissions and withdrawals be permitted as frequently as valuation dates. Section 9.18(b)(1)(iv), however, requires a CIF plan to establish the terms and conditions governing admission and withdrawal. The "Admission and Withdrawal of Accounts" section below discusses the factors the OCC has considered when authorizing CIF plans that restrict admissions and withdrawals.

[5] IL 716 cites Statement of Position 94-4 (SOP 94-4), "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Plans," issued by the American Institute of Certified Public Accountants (September 23, 1994), as a basis for the OCC's interpretation.

Admission and Withdrawal of Accounts – 9.18(b)(5)

The admission and withdrawal requirements for CIFs provide flexibility so long as certain standards are met. These standards are designed to ensure that a bank treats all participating accounts fairly when governing the timing of admissions and withdrawals and when determining a fund's value for the purpose of admissions and withdrawals.

First and foremost, a bank may only admit an account to a CIF or withdraw an account from the fund on the basis of the valuation process established in the plan. This means that admissions to and withdrawals from a fund must be processed as of a specified time on an established valuation date and must be based on the market value of the fund's assets as of such time. Banks must ensure that "late trading" of their CIFs does not occur. A bank cannot provide different fund valuations to accounts that enter or withdraw from the same CIF on the same valuation date. A bank is also prohibited from allowing one account to withdraw from a CIF while barring withdrawals for all other accounts.

At the time it establishes a fund, a bank is required to establish in the written plan the terms and conditions that govern the admissions and withdrawals of participating accounts. A bank's CIF plan should state that the CIF can admit or withdraw an account at a certain asset value only if the bank (either directly or through a designated third party) accepts a request for the admission or withdrawal, or has received a notice of the account's intent to take such an action, on or before the time when the fund's assets are revalued. If the bank in those circumstances were to process the admission or withdrawal after the new valuation date at the previous net asset value, the institution would be allowing prohibited "late trading."

A bank may operate similar funds that have different notification periods depending upon the nature of the accounts that will have admissions and withdrawals from the funds. In addition, for A2 funds that are invested primarily in assets that are not readily marketable, a bank may require a prior notice period not to exceed one year for withdrawals.

The OCC recognizes that some CIFs contain illiquid assets, such as interests in private equity limited partnerships and hedge funds. To the extent that a bank has valid reasons for limiting admissions and withdrawals for one of these funds, and these restrictions are consistent with the bank's fiduciary duties, a bank may establish an A2 fund that severely restricts admissions to and withdrawals from the fund. While, to date, the OCC has provided this flexibility only to certain A2 funds, a bank sponsoring an A1 fund that has similarly sophisticated investors and that invests in similarly illiquid investments could request comparable authority.

Method of Distributions and Segregation of Investments – 9.18(b)(5)(iv) and 9.18(b)(5)(v). A bank has several options when making distributions to accounts withdrawing from a fund. It may make distributions in cash, ratably in kind, a combination of cash and ratably in kind, or in any manner consistent with applicable law in the state in which the bank maintains the fund. This flexible approach is designed so that a bank has the ability to address complex distributions (such as CIFs with illiquid assets or assets that may not be transferred) while still maintaining the basic protections of state fiduciary law. In addition, this provision enables either a bank administering a CIF, or beneficiaries or other interested parties of fiduciary accounts in that fund, to seek a court order from a court of competent jurisdiction, authorizing an equitable solution if issues arise regarding distribution of fund assets.

To the extent a bank withdraws an investment in kind from a CIF for the benefit of all participants in the fund at the time of the withdrawal, but the investment is not distributed ratably in kind, the bank is required to segregate and administer the investment for the benefit ratably of all the participants in the fund at the time of the withdrawal.

Audits and Financial Reports – 9.18(b)(6)

Every CIF must be audited at least once every 12 months by auditors responsible only to the bank's board of directors. The OCC provides a narrow exemption from the audit requirement for funds that consist exclusively of IRAs, Keogh accounts, or other employee benefit accounts that are exempt from taxation and registered under the '40 Act. If those funds comply with section 10(c) of the '40 Act, which authorizes certain director affiliations between the fund and the bank, then those funds may use their '40 Act audit, so long as they provide a copy of their audit report to the administering bank.

A bank must also prepare a financial report, based on the annual audit, at least once during each 12-month period for each CIF it administers. The financial report must disclose the fund's fees and expenses in a manner that is consistent with applicable law in the state in which the bank maintains the fund.

At a minimum, the financial report must contain the following items:

- A list of investments in the fund showing the cost and current market value of each investment; and

- A statement covering the period after the previous report showing the following (organized by type of investment):

- A summary of purchases (with costs);
- A summary of sales (with profit or loss and any other investment changes);
- Income and disbursements; and
- An appropriate notation of any investments in default.

A bank may include in the financial report a description of the fund's value on previous dates, as well as its income and disbursements during previous accounting periods. A bank may not, however, publish in the financial report any predictions or representations as to future performance. To ensure that A1 funds fall within the exclusion from the definition of an investment company under section 3(c)(3) of the '40 Act, 9.18(b)(7) imposes an additional advertising restriction on banks administering these funds.

A bank must provide either a copy of the financial report, or must provide notice that a copy of the report is available without charge, to each person who ordinarily would receive a regular periodic accounting with respect to each participating account. Banks may also provide copies of the financial report to prospective customers. While banks are required to provide a copy of this report to any requestor, they may impose a reasonable charge for them.

Advertising Restriction – 9.18(b)(7)

A bank may not advertise or publicize an A1 fund except in connection with advertising the general fiduciary services of the bank. This prohibition is intended to ensure that banks operate A1 funds in compliance with the '40 Act's exclusion of A1 funds from the definition of an investment company. Section 3(c)(3) of the '40 Act restricts both the advertising of these A1 funds and the offering of these funds to the general public. There is no similar prohibition on advertising with respect to A2 funds that operate within the parameters in section 3(c)(11) of the '40 Act.

The OCC has cautioned national banks that the antifraud provisions of the securities laws apply to both A1 and A2 funds. The OCC recommends that banks conform any advertisement of their A2 funds to SEC and NASD guidance to avoid a potential securities law violation. When advertising their A2 funds, banks should be particularly wary of making projections of future performance, providing unsubstantiated historical performance data, or using language that suggests the bank will guarantee or ensure a fund's future performance.

Self-Dealing and Conflicts of Interest – 9.18(b)(8)

The self-dealing and conflicts of interest provisions that apply to all fiduciary relationships (12 CFR 9.12) apply to bank-administered CIFs.

The OCC, however, has authorized banks to self-deposit funds awaiting investment or distribution in a STIF that invests primarily in own-bank certificates of deposits and other deposit products. The apparent conflict of interest in this arrangement is authorized by "applicable law," specifically 12 CFR 9.10. The standard set forth in section 9.10 requires a bank to establish that the conflict is "not prohibited by applicable law." (The customary standard for conflicts of interest requires a conflict to be "authorized by applicable law.") Refer to the "Conflicts of Interest" booklet of the *Comptroller's Handbook* for more information about conflicts that arise in the fiduciary context.

In addition to section 9.12, the OCC identifies three specific areas in section 9.18(b)(8) related to CIFs where conflicts of interest may arise:

- **Bank interests.** A bank administering a CIF is prohibited from having an interest in that fund other than in its fiduciary capacity. When the bank acquires an interest in an account that participates in a bank-administered CIF, through a creditor relationship or otherwise, the bank must withdraw that account from the CIF at the next withdrawal date. A bank is permitted, however, consistent with section 408(b)(1) of ERISA, to invest assets of an EB plan that the bank operates for the benefit of its own employees or employees of an affiliate in CIFs that the bank administers.

- **Loans to participating accounts.** A bank is prohibited from making any loan the collateral for which is a participant's interest in a CIF administered by the bank. A bank is authorized, however, to make an unsecured advance to a fiduciary account that participates in a bank-administered fund, so long as the advance extends only until the fund's next valuation date. This exemption enables a bank to avoid overdrafts on the participating accounts.

- **Purchase of defaulted investments.** When a bank-administered CIF holds a defaulted investment, the bank should promptly withdraw the investment from the fund and segregate and administer it for the benefit of all fund participants, proportionate to each participant's interest in the fund at the time of withdrawal of the investment. The OCC recognizes an exemption from this requirement when the bank determines that the cost of segregating the investment is excessive in light of the investment's market value. In those instances, the bank is authorized to purchase the defaulted investment for its own account at the greater of market value or the sum of cost and accrued unpaid interest.

Management Fees and Expenses – 9.18(b)(9) and 9.18(b)(10)

The CIF management fee regulation provides that a national bank may charge a CIF a reasonable management fee only if:

1. The fee is permitted under applicable law (and complies with fee disclosure requirements, if any) in the state in which the bank maintains the fund; and

2. The amount of the fee does not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating accounts that would not have been provided to the accounts were they not invested in the fund.

Essentially, a bank may charge a fee for managing a CIF provided that the participant's share of that fee, together with the other fees charged to that participant, do not exceed the fees the participant would have paid for services if the bank had not invested the participant's assets in the fund. A bank may charge different management fees to fund participants commensurate with the amount and types of services provided to fund participants. These variations in fees may be reflected in the number of units a participant receives. For example, if two participants are admitted with the same amount of money to invest, the bank is allowed to provide more units of the CIF to the one requiring fewer services.

A bank administering a CIF may charge reasonable expenses incurred in operating the fund to the extent not prohibited by applicable law in the state in which the bank maintains the fund. A bank must, however, absorb all expenses associated with the establishment or reorganization of a CIF. The regulation does not specifically define which expenses are "reasonable" and which are not.

The OCC has authorized banks to charge reasonable expenses directly associated with operating a CIF. Those expenses include, for instance, an audit of a fund; the cost of publishing the annual financial report; all costs, commissions, taxes, transfer taxes, legal fees, and other expenses associated with the purchase or sale of CIF assets; and all other reasonable costs incurred in the operation and administration of a fund.

A national bank is generally prohibited from passing brokerage and related fees associated with accounts being admitted to or withdrawn from a CIF to each participating account in the CIF. If this practice were allowed, long-term CIF participants could end up absorbing the costs associated with the admission and withdrawal of shorter term participants in the CIF.

However, an “index CIF” may charge brokerage fees and other costs to fund participants that are either admitted to or that withdraw from an index CIF. Index CIFs seek to replicate the performance of a specified index, such as the Standard and Poor’s 500 Index. Trading decisions are made according to a formula that tracks the rate of return of the index by replicating the entire portfolio of the index or by investing in a representative sample of that portfolio. The OCC has also authorized a bank that administers “model-driven” A2 funds to charge these costs to participants at the time they are admitted to or withdrawn from the fund. A “model-driven fund” is a fund that seeks to outperform a third-party index based upon certain pre-specified formulae or algorithms, and is quantitative in nature.

Generally, a bank may not charge participants with the cost of entering or exiting a CIF. However, the payment by an index or model-driven CIF of brokerage fees and expenses in order to accommodate a participant either entering or exiting the fund could negatively affect the fund’s return relative to the index or model for the remaining fund participants. To mitigate that impact, and in light of the limited discretion of the fund manager for an index or model-driven fund, the OCC has allowed funds with these investment strategies to allocate these costs to participants being admitted or withdrawn from either index or model-driven funds, provided that the CIF plan document discloses these charges.

While OCC regulations enable banks to develop flexible and competitive fee structures, a national bank fiduciary must ensure that it does not charge excessive fees or make decisions to invest in a particular product, such as a mutual fund, solely to maximize the revenues of the bank or an affiliate. See Banking Circular 233, “Acceptance of Financial Benefits by Bank Trust Departments” (February 3, 1988), and “Use of Mutual Funds as Fiduciary Investments” (appendix E) in the *Comptroller’s Handbook* “Conflicts of Interest.” The OCC has acknowledged that a bank may invest CIF assets in either bank-affiliated or third-party mutual funds and may receive both reasonable trust management fees from its customers and fees from the mutual fund for providing services to that fund, provided that these actions are consistent with applicable law.

Fees must be commensurate with the value of services provided. Unless authorized by applicable law, a bank should be careful not to double-charge a fund for fees already charged by a sub-adviser for the same services. In these situations, the bank must not only determine whether the investment is prudent and appropriate for each of the trust accounts, given the investment alternatives realistically available, but must also periodically review the prudence of retaining these investments.

The ’40 Act authorizes mutual funds to pay certain fees (“12b-1 fees”) to third parties to defray the cost of shareholder servicing and administrative services. These fees frequently are used to compensate banks for providing services such as placing orders, processing purchases, processing dividend and distribution payments, and responding to customer inquiries. When a bank receives 12b-1 fees from a mutual fund based upon investments in that fund by a bank-administered CIF, the bank should ensure that applicable law authorizes its receipt of the fee and that the bank discloses receipt of that fee to fund participants.

In addition to 12b-1 fees, some mutual fund complexes pay “finder fees” and other compensation to investors for placing their investments with a particular fund or for retaining their investments over time with a particular fund or fund complex. A bank administering a CIF must ensure that such fees are consistent with the OCC’s self-dealing and fee regulations and with SEC and other applicable guidance in this area.

Prohibition Against Certificates – 9.18(b)(11)

To avoid any potential compliance issues with the securities laws, a bank that administers a CIF may not issue a certificate or other document that represents a direct or indirect interest in the fund. A bank may, however, provide a withdrawing account with a document that reflects a continuing interest in an investment that has been segregated.

Good Faith Mistakes – 9.18(b)(12)

The OCC recognizes that a bank may unknowingly run afoul of one of the CIF regulations. To motivate banks that administer CIFs to correct their good faith mistakes as promptly as possible, the regulation provides that the OCC will not determine that a bank has violated the CIF regulations when a bank makes a good faith mistake while exercising due care in connection with administering a CIF. This limited exemption applies so long as the bank, promptly after the discovery of the mistake, takes whatever action is practicable under the circumstances to remedy the mistake.

Collective Investment Funds and the ‘40 Act

The Investment Company Act of 1940 (the ’40 Act) regulates the formation and operation of investment companies (e.g., mutual funds). The ’40 Act contains two specific exclusions from the definition of “investment company” that allow banks to operate CIFs without registering them with the SEC. The first exclusion, section 3(c)(3) of the ’40 Act, generally covers all A1 funds. It provides an exclusion from investment company registration for any common trust fund or similar fund maintained by a bank that is exclusively for the collective investment and reinvestment of moneys contributed by the bank in its capacity as a trustee, executor, administrator, or guardian, if:

1. A bank sponsors the CIF solely as an aid to the administration of trusts, estates, or other accounts created and maintained for a fiduciary purpose;
2. Interests in the CIF are not advertised or offered for sale to the general public except in connection with the ordinary advertising of the bank’s fiduciary services; and
3. Fees and expenses charged by the CIF do not violate fiduciary principles established under applicable federal or state law.

In 1999, the Gramm-Leach-Bliley Act narrowed the ’40 Act’s statutory exclusion under section 3(c)(3). GLBA imposed additional restrictions on a bank’s ability to advertise a CIF and to make it available to the general public, and further limited the fees these funds may charge. These statutory restrictions generally codified previous SEC interpretations that limited a bank’s ability to market A1 funds.

Section 3(c)(11) of the ’40 Act, which was not narrowed by the GLBA legislation, provides an exclusion from the registration, disclosure, and recordkeeping requirements of the ’40 Act for most A2 funds. Among other things, it exempts any “collective trust fund maintained by a bank” consisting solely of assets of:

- Any employee’s stock bonus, pension, or profit-sharing trusts which meet the requirements for qualification under section 401 of the Internal Revenue Code of 1986, and
- Governmental plans.

The ’40 Act’s exclusions under 3(c)(3) and 3(c)(11), like the ’33 Act exemptions, do not expressly cover CIFs that contain IRA assets. This is because IRAs are created under a different IRC section than qualified employee benefit plans, and IRAs receive their preferred tax treatment under a different IRC section. (See appendix D, "Specialized Collective Investment Funds.") Health Savings Accounts (HSAs), and related tax-advantaged savings vehicles, raise similar issues. A bank should consult with securities counsel before commingling these assets in a CIF.

National banks should also consult with securities counsel if they intend to combine different assets (e.g., personal trust and pension assets) in a single CIF. While section 9.18(a)(2)(i) expressly authorizes these combinations, a bank should obtain specific securities law advice in this area. Banks should also consider potential securities law restricting the investment of fiduciary assets held by one bank into an A1 fund of an unaffiliated institution. While SEC guidance authorizes affiliated banks under a single holding company to combine their A1 and A2 funds, the SEC has not authorized a bank's consolidation of assets from unaffiliated banks into a single A1 fund. This restriction may apply even where applicable law (state trust law or the governing instrument) expressly authorizes a trustee to invest the assets in an unaffiliated bank's CIF.

A national bank that is considering operating a CIF that does not clearly meet either the 3(c)(3) or 3(c)(11) exclusions of the '40 Act or the related exemptions of the '33 Act should ensure that securities counsel has reviewed the proposed fund. If the fund violates securities laws, the SEC may take enforcement action against the bank, including the imposition of penalties. The OCC is also authorized to take remedial action if a national bank violates securities laws.

If a bank determines that a CIF must be registered because the fund does not meet the exemptions under the '40 Act, the bank must also determine whether it must register interests in the CIF as a "security" under the '33 Act.

Specialized Collective Investment Funds

This section highlights certain special-purpose CIFs that hold selected assets that may be operated in compliance with limited securities law exemptions. These funds may be operated under exemptions that do not generally apply to CIFs.

Individual Retirement Accounts (IRAs) are authorized as tax-exempt accounts under section 408 of the IRC. OCC and IRS regulations authorize a bank to invest IRA assets in a CIF. Under the SEC's interpretation of the securities laws, however, a bank that operates a CIF and invests IRA assets in that fund may be considered to be operating the CIF in violation of the '33 Act and '40 Act. The SEC, however, has expressly authorized banks to operate CIFs that accept IRAs if those funds are registered with the SEC as registered investment companies under the '40 Act and as securities under the '33 Act.

Keogh plans (retirement plans for self-employed individuals) are authorized as tax-exempt under section 401(c)(1) of the IRC. Because Keogh plans, like IRAs, are not authorized as tax exempt under section 401(a) of the IRC, the securities laws may be interpreted so as to prevent a bank from collectively investing IRA assets or Keogh plan assets in a CIF unless the fund is registered as an investment company and a security. Under this interpretation of the securities laws, only employee benefit plans qualified under section 401(a) of the IRC may be invested in A2 funds. In the absence of guidance from securities law counsel, a bank should be careful not to place IRA or Keogh assets in a CIF unless the fund qualifies for a specific exemption or is registered under the securities laws.

The SEC has recognized only limited exemptions from '33 Act registration for a CIF that contains Keogh funds. For example, '33 Act Rule 180 contains a "sophisticated investor" exemption from '33 Act registration for CIFs holding Keogh account assets when the plan is either a single employer or has only employees of interrelated partnerships and when:

- The employer is a law firm, accounting firm, investment banking firm, pension consulting firm, or investment advisory firm that is engaged in furnishing services of a type that involve such knowledge and experience with financial and business matters that the employer is able to represent adequately its interests and those of its employees; or
- Before adopting the plan, the employer obtains expert financial advice from an entity, which is independent of the bank operating the CIF, that by virtue of knowledge and experience in financial and business matters is able to represent adequately the interests of the employer and its employees.

In addition to the narrow ’33 Act rule 180 exemption, a CIF holding Keogh funds may also be structured to qualify for the “intrastate exemption” under section 3(a)(11) of the ’33 Act. For the intrastate exemption to be available, however, all of the interests in the CIF must be sold within a single state or territory, and the parties to that plan must all reside and do business within that state. Any commingling of intrastate Keogh plan assets with assets from another state may nullify this exemption.

Laws

12 USC 92a

Employee Retirement Income Security Act of 1974 (ERISA)

The Gramm-Leach-Bliley Act of 1999

Internal Revenue Code Investment Company Act of 1940 ('40 Act)

Securities Act of 1933 ('33 Act)

Securities Exchange Act of 1934 ('34 Act)

Regulations

12 CFR 9, Fiduciary Activities of National Banks

17 CFR 230.132, ('33 Act Rule 132)

17 CFR 270.2a-7 and 3c-4, ('40 Act Rules 2a-7and 3c-4)

OCC Issuances

Banking Circular 196, "FFIEC Supervisory Policy – Securities Lending" (May 7, 1985)

Banking Circular 233, "Acceptance of Financial Benefits by Bank Trust Departments" (February 3, 1989)

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